

**BEFORE THE UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION**

Transparency Provisions of the)
Energy Policy Act of 2005)

Docket No. AD06-11-000

COMMENTS OF THE U.S. DEPARTMENT OF JUSTICE

In hearings held in this docket on October 13, 2006, staff of the Federal Energy Regulatory Commission called for comments regarding the Commission's new authority under the Energy Policy Act of 2005 ("EPAAct")¹ to issue rules regarding transparency in electricity and natural gas markets. EPAAct explicitly provides that the Commission may issue rules mandating the collection and public dissemination of information about natural gas and electricity markets.² The Department of Justice files these comments concerning the potential competitive effects on electricity and related markets³ of the public dissemination of such information.

In deciding whether to adopt new rules on transparency, the Commission should consider carefully the potential benefits and costs. In general, transparency may promote market efficiency by facilitating efficient production and investment, ultimately reducing prices for consumers. However, many electricity and related markets have structural characteristics that

¹ Energy Policy Act of 2005, §§ 316 and 1281, Pub. L. No. 109-59, 119 Stat. 594, 691-92 and 978-79 (2005).

² Id.

³ Related markets include capacity and ancillary services markets that may fall under the Commission's jurisdiction. Although the Department's comments focus on electricity and related markets, the same general considerations addressed in them also apply to natural gas markets.

make them susceptible to coordinated interaction,⁴ so increasing transparency in them by mandating public disclosure of detailed firm- and transaction-specific information may increase the risks of coordination that raises prices to consumers. Moreover, given the amount of information currently available in many of these markets, the incremental benefit of increased public dissemination of firm- and transaction-specific information may be small relative to the risks of coordination. Should the Commission decide to issue new rules calling for the dissemination of additional information, it can reduce the potential for facilitating coordination by adopting certain safeguards, including aggregating information, masking the identities of individual participants, and releasing information with an appropriate time lag.

I. BENEFITS OF TRANSPARENCY: INCREASED EFFICIENCY

A. Efficiency in Production

One important benefit of market transparency is that it can increase short-run efficiency by providing appropriate signals to suppliers about how much to produce. For example, a generator must decide how much electricity to produce, given its generating capacity. Information regarding the actual or expected price of electricity is important in making the efficient decision. Moreover, other information concerning future market conditions, such as forecast supply and demand conditions, permits the generator to better forecast expected prices. The greater the amount of information available to generators about market prices and the factors that affect prices, the better will be forecasts about the profitability of running a generating unit

⁴ “Coordinated interaction is comprised of actions by a group of firms that are profitable for each of them only as a result of the accommodating reactions of the others. This behavior includes tacit or express collusion, and may or may not be lawful in and of itself.” U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 2.1, reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,104 (April 2, 1992).

and the less likely it is that “too much” or “too little” electricity will be produced: electricity will more likely be produced only when its costs are covered.

B. Efficiency in Investment

Another key benefit of market transparency is that it can increase long-run efficiency by providing appropriate signals to suppliers and potential suppliers about how much to invest. For example, information about prices for electricity to be delivered in the future permits a generator or a potential entrant into generation to better assess the profitability of investing in a new generating unit. Similarly, information concerning the conditions that affect the price expected to prevail (e.g., expected supply and demand conditions) permits the generator to better forecast expected prices and assess likely investment profitability. Such price signals help reduce the risk that either “too much” or “too little” investment takes place: a forecast that under-predicts future prices results in too little investment, a forecast that over-predicts future prices results in too much investment. Thus, transparency may make predictions of future prices more accurate, permitting more efficient investment decisions to be made in the long run.⁵

C. Existing Degree of Transparency

A great deal of information about market participants, market conditions and market transactions is available to the public in electricity and related markets. The Commission itself

⁵ There are several other potential benefits to transparency, including enhanced market monitoring. Placing information in the hands of regulators, market participants, and observers may enhance the effectiveness with which markets are monitored for unwarranted exercises of market power. It is important to note, however, that at least some of the market monitoring benefits of transparency can be obtained by providing information to regulators on a confidential basis, permitting them to monitor markets while avoiding the potential anticompetitive consequences of more broadly disseminating firm- and transaction-specific information to the public.

makes public highly detailed information regarding these markets. For example, it disseminates detailed cost information, collected in Form 1, for generating units; it also makes public the terms of wholesale electricity sales collected in the Electric Quarterly Reports. Commercial services also disseminate information about electricity and related markets, including the real-time operating status and output of generating plants, and bilateral bids and offers for wholesale electricity and capacity. Finally, several independent system operators also disseminate detailed information about their markets, including current and historical price and quantity information, as well as forecasts of expected supply and demand conditions. All of this public information facilitates efficient production and investment decisions.

II. COSTS OF TRANSPARENCY: INCREASED LIKELIHOOD OF COORDINATION

As is generally recognized, public disclosure of firm-specific or transaction-specific information may reduce competition in wholesale electricity markets by facilitating coordinated actions by suppliers that can harm consumer welfare.⁶ Such coordinated action can involve either the formation of an agreement, which almost certainly would violate the antitrust laws, or mutual interdependence, which is not likely to violate the antitrust laws. Successful coordinated interaction of either type entails three critical tasks: (1) reaching terms of coordination that are profitable to the suppliers involved; (2) detecting deviations from the terms that would undermine the coordinated interaction; and (3) punishing such deviations. Certain market

⁶ See Energy Policy Act of 2005, §§ 316 and 1281, Pub. L. No. 109-59, 119 Stat. 594, 691-92 and 978-79 (2005) (stating that the Commission “shall seek to ensure that consumers and competitive markets are protected from the adverse effects of potential collusion or other anticompetitive behaviors that can be facilitated by untimely public disclosure of transaction-specific information.”). Cf. U.S. Department of Justice and Federal Trade Commission, *supra* note 4, § 2 (discussing factors affecting the likelihood of coordination, including the extent of information available to firms in the market).

conditions present in some electricity and related markets – transparency, high concentration, impediments to entry, a homogeneous product, and a low elasticity of demand – may make it easier for suppliers to perform these tasks. Each of these market conditions is discussed briefly below.

- *Transparency.* Transparency may increase the amount of direct information available to suppliers about actions taken by other sellers. The more detailed this information, the better suppliers will be able to determine whether their rivals are adhering to the terms of coordination. When such information is made available quickly to suppliers, they will be able to more quickly punish deviations from terms of coordination. And anticipating that it will be easier to detect and punish deviations from the terms of coordination, suppliers also may find it easier to coordinate their actions. As noted above, many electricity markets already are very transparent.

- *High Concentration.* Fewer suppliers in a market may make it easier for suppliers to reach, as well as detect deviations from, terms of coordination, increasing the likelihood that terms will be reached. For example, in more concentrated markets the market share of a given supplier will, on average, tend to be larger; and the larger its share, the more a supplier will gain from an increase in price and the greater will be the incentive to reach terms of coordination. Moreover, if a supplier with a relatively large market share deviates from the terms of coordination by underpricing, the greater the effect on price and the more noticeable is the deviation. High concentration arises, for example, in certain wholesale electricity markets when transmission constraints leave only a few generators capable of supplying energy to the constrained area.

- *Impediments to Entry.* The greater are impediments to entry, the less likely it is that coordination among existing suppliers will be disrupted by the prospect of competition from new suppliers. There are significant impediments to quick entry in wholesale electricity markets. For example, it typically takes a minimum of two years to construct a small generating plant, and it can take several years to construct a larger plant. In addition, it can take several years to construct a substantial amount of new transmission capacity that might allow generation from more distant locations to enter a transmission-constrained area.

- *Homogeneous Products.* If suppliers offer products that are differentiated by quality, a supplier may deviate from terms of coordination by offering a higher quality product. By contrast, suppliers of a homogeneous product compete primarily on price, making it easier for suppliers to reach and detect deviations from terms of coordination. Homogeneous products, such as standard block products and capacity, often are traded in wholesale electricity markets, increasing the risk of coordination.

- *Low Elasticity of Demand.* The less elastic demand is for a product, the higher the price that coordinating suppliers can profitably set, the greater the gains to coordination, and the more likely it is that suppliers will coordinate their actions. In electricity markets, demand typically is inelastic in the long run and highly inelastic in the short run, which may allow generators to increase price sharply by coordinating.

Given that electricity and related markets may have characteristics that make them susceptible to coordination, the Commission in general should be wary of increasing transparency by mandating rapid disclosure of highly-detailed, firm- or transaction-specific information. In particular, the Commission should be particularly wary of mandating disclosure

of such information in spot markets for electricity and forward markets for standard block electricity products, both of which have many of the characteristics that may render a market susceptible to coordination.

IV. SAFEGUARDS AGAINST COORDINATION

The potential anticompetitive consequences of increased transparency via disclosure of firm- and transaction-specific information can be limited through three practical safeguards: aggregation, masking, and lagging. First, appropriately aggregated information makes it difficult for suppliers to determine whether others are abiding by terms of coordination; knowing that it is difficult to detect deviation from those terms, suppliers will be less likely to reach terms of coordination. Second, and for the same reason, appropriately masking firm- or transaction-specific information would hinder suppliers from using the data to reach terms or from detecting and punishing a deviation from terms of coordination. Even if it is deemed appropriate to disseminate firm-specific or transaction-specific data, masking the identity of the parties to the transaction may deter coordination by undermining the usefulness of the data to reach terms of coordination. Finally, releasing information with a time lag will keep suppliers from immediately knowing whether others have abided by or deviated from terms of coordination, increasing the likelihood that deviations will occur, and thereby undercutting both the likelihood and likely effectiveness of coordination.

V. CONCLUSION

As the Commission considers whether to issue new rules regarding transparency, the Department urges it to consider carefully the characteristics of, and the degree of information currently available in, electricity and related markets to avoid unnecessarily increasing the

likelihood of coordination in them. If the Commission decides to issue rules calling for the dissemination of highly detailed information about these markets, it should keep in mind that it may be able to achieve the benefits of transparency while limiting its potential harm by aggregating, masking, and lagging the release of such information.

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